

**WATER/KPC/FLC/KOK/DLW/AML**

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**WATER DIVISION  
AUDIT AND COMPLIANCE BRANCH**

**RESOLUTION W-4597  
April 27, 2006**

**R E S O L U T I O N**

**RESOLUTION W-4597. YERBA BUENA WATER COMPANY (YBWC). ORDER CONDITIONALLY AUTHORIZING YERBA BUENA WATER COMPANY TO SECURE LOANS TOTALING \$85,000 FOR VARIOUS EMERGENCY REPAIR WORK ON ITS WATER SYSTEM AND TO ENCUMBER UTILITY ASSETS.**

**By Advice Letter (AL) No. 33 filed on January 6, 2006.**

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**SUMMARY**

This Resolution conditionally grants the authority requested by YBWC in AL No. 33.

YBWC requests authority, pursuant to §§ 816 through 830 of the Public Utilities Code, for six existing emergency loans totaling \$85,000, secured from a private lender, and the encumbrance of assets in connection with the loans.<sup>1</sup>

**NOTICE AND PROTESTS**

Notice of AL No. 33-W was made by publication in the Commission's Daily Calendar of January 9, 2006. No protests have been received.

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<sup>1</sup> All statutory references are to the Public Utilities Code unless otherwise indicated.

## **BACKGROUND**

YBWC is a Class D water utility subject to the jurisdiction of this Commission. YBWC provides water to 228 metered rate customers in an area adjacent to the Pacific Ocean, in Ventura County. Pursuant to its 2004 Annual Report, YBWC reported that it generated total operating revenues of \$124,262 and net income of \$27,109 in 2004.

The company's balance sheet, dated December 31, 2004, is summarized below:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$ 111,278
Accounts Receivable - Customers	932
Current Assets	3,146
Other Current Assets	<u>30,000</u>
Total Assets	<u>\$ 145,356</u>
<u>Liabilities &amp; Equity</u>	
Common Stock	\$ 26,000
Other Paid-in Capital	445,319
Retained Earnings	(325,963)
Net Contributions in Aid of Construction	<u>0</u>
Total Liabilities & Equity	<u>\$ 145,356</u>

Beginning in 2004, YBWC entered into the following loans, without first procuring Commission authority:

### Promissory Note #1

YBWC secured the \$14,070.04 loan from Crown Pointe Estates at Malibu, LLC, on December 23, 2004 at a rate of 8% per annual payable over 10 years. The loan amount was used to repair a water leak at Whalers Village on December 9 and December 10, 2004. The work was performed by

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Channel Islands Pipeline, Inc. as evidenced by invoice #3741 dated  
December 15, 2004, in the amount of \$14,070.04.

#### Promissory Note #2

YBWC secured the \$21,382.16 loan from Crown Pointe Estates at Malibu, LLC, on March 15, 2005 at a rate of 8% per annual payable over 10 years. The loan amount was used to repair and replace pipes at Sycamore Creek on February 14, February 15, and February 16, 2005. The work was performed by Channel Islands Pipeline, Inc. as evidenced by invoice #3810 dated February 14, 2005, in the amount of \$21,382.16.

#### Promissory Note #3

YBWC secured the \$19,171.20 loan from Crown Pointe Estates at Malibu, LLC, on June 30, 2005 at a rate of 8% per annual payable over 10 years. The loan amount was used to repair leakage at Neptune's Net from June 14 through June 17, 2005. The work was performed by Channel Islands Pipeline, Inc. as evidenced by invoice #3871 dated June 20, 2005, in the amount of \$19,171.20.

#### Promissory Note #4

YBWC secured the \$8,463.32 from Crown Pointe Estates at Malibu, LLC, on August 2, 2005 at a rate of 8% per annual payable over 10 years. The loan amount was used to replace a water main across from Neptune's Net from June 21 through June 29, 2005. The work was performed by Channel Islands Pipeline, Inc. as evidenced by invoice #3877 dated June 30, 2005, in the amount of \$8,463.32.

#### Promissory Note #5

YBWC secured the \$11,731.06 from Crown Pointe Estates at Malibu, LLC, on August 2, 2005 at a rate of 8% per annual payable over 10 years. The loan amount was used to replace a water line in Ventura County from July 8 through July 12, 2005. The work was performed by Channel Islands Pipeline, Inc. as evidenced by invoice #3881 dated July 14, 2005, in the amount of \$11,731.06.

Promissory Note #6

YBWC secured the \$10,000.00 from Crown Pointe Estates at Malibu, LLC, on December 7, 2005 at a rate of 8% per annual payable over 10 years. The loan amount was used to replace partial replacement of a water main on Ellice Street dated November 3, 2005, and a replacement of a valve at Whalers Village on November 23, 2005. The work was performed by Channel Islands Pipeline, Inc. as evidenced by Invoice #3964 dated November 25, 2005 in the amount of \$14,465 and Invoice #3965 dated November 25, 2005 in the amount of \$6,490. YBWC applied the loan of \$10,000.00 plus \$10,995.00 in its general account to pay in full Invoices #3964 and #3965.

The following is a summary of the construction costs:

<u>Description</u>	<u>Amount</u>
Invoice # 3741 dated December 15, 2004	
Repair Water leak (includes materials and labor)	\$14,070.04
Invoice #3810 dated February 14, 2005	
Repair and replace pipes (includes materials and labor)	21,382.16
Invoice #3871 dated June 20, 2005	
Repair Leakage (includes materials and labor)	19,171.20
Invoice #3877 dated June 30, 2005	
Replace a water main (includes materials and labor)	8,463.32
Invoice #3881 dated July 14, 2005	
Replace a waterline (includes materials and labor)	11,731.06
Invoice #3964 dated November 25, 2005	
Replace a Water main (includes materials and labor)	14,465.00
Invoice #3965 dated November 25, 2005	
Replace a Water Valve (includes materials and labor)	<u>6,490.00</u>
Total Cost	<u>\$95,772.78</u>

The above construction costs were funded by Crown Pointe Estates at Malibu, LLC and by YBWC's internal funds.

YBWC's capital ratios as of December 31, 2004, are presented below as recorded and as adjusted, to give pro forma effect to the total loan of \$85,000:

	Recorded		Pro Forma	
Long-Term Debt	\$	0	0.00%	\$ 85,000 36.80%
Short-Term Debt		<u>0</u>	<u>0.00%</u>	<u>0</u> <u>0.00%</u>
Total Debt		0	0.00%	85,000 36.90%
Preferred Stock		0	0.00%	0 0.00%
Common Stock		26,000	17.89%	26,000 11.29%
Paid in Capital &				
Retained Earnings		<u>119,356</u>	<u>82.11%</u>	<u>119,356</u> <u>51.81%</u>
Total Capitalization		<u>\$145,356</u>	<u>100.00%</u>	<u>\$230,356</u> <u>100.00%</u>

The last General rate increase of YBWC became effective on June 8, 2000, pursuant to Resolution No. W-4197. The company's last CPI Increase became effective on December 8, 2003, pursuant to Resolution No. W-4197.

## **DISCUSSION**

YBWC is in violation of the provisions of Article 5, Stocks and Security Transactions, of the Public Utilities Code, for its failure to secure Commission authorization prior to incurring the indebtedness discussed above.

While we are concerned when a utility proceeds to execute debt without first obtaining Commission authorization, as the Public Utilities Code requires, we do recognize that there are mitigating circumstances in this instance. YBWC was faced with emergency repairs in six of its system potable water mains from December, 2004 thru December, 2005. YBWC saw service restoration as its first priority and on its own initiative, determined that action was required, sought out needed funding, and began its repair and replacement efforts. However, YBWC violated the Public Utilities Code and the offending transactions are thereby void under § 825, which states in part:

All stock and every stock certificate or other evidence of interest or ownership, and every bond, note, or other evidence

of indebtedness, of a public utility, issued without an order of the commission authorizing the issue thereof then in effect or not conforming in its provisions to any of the provisions which it is required by the order of authorization to contain, is void.

The Commission doesn't have the power to validate debt which, under the Public Utilities Code, is *void ab initio*. A debt for which the Commission's authorization is necessary is void unless such authorization has been secured, and the Commission has no power to make valid an act which is void.

Because YBWC is desirous of rectifying its omission, the Commission may direct the cancellation of such debt issued without authority and authorize the execution of a new debt instrument in lieu thereof.

Decision (D.) 92-10-024, dated October 6, 1992, and D.94-09-025, dated September 1, 1994, denied Alco Water Service retroactive approval of certain unauthorized borrowings and required it to make arrangements for the issuance of new promissory notes to rectify several previously negotiated long-term loans and stock repurchases done without Commission approval. D. 87-08-017, dated August 12, 1987, directed Southern California Water Company to execute a new note, even though the utility had already executed a note without authority and expended the funds for a steel water reservoir, land rights and appurtenant equipment.

The proceeds of the six promissory notes executed by YBWC were used for various emergency repairs of the water system. Crown Pointe Estates at Malibu has been the lending arm of YBWC for the past 25 years and have assisted the company with its funding requirements that commercial banks cannot provide. YBWC incurred losses for the years 2000 through 2003:

2000	(\$21,267.00)
2001	(\$12,457.00)
2002	(\$39,970.00)
2003	(\$21,096.00)

Retained earnings as of 2004 was a negative \$325,963. YBWC claims that no bank or commercial lender would extend credit to a financially weak company with about 200 customers. If ever a bank would extend credit, it would take time to negotiate, it would be more costly, and it would require not only encumbrance of utility assets but likewise personal surety of the owners. YBWC claims it is fortunate that Crowne Pointe Estates provides external funds to the company.

Staff recognizes YBWC's precarious condition. We note that in Decision 92-03-093 dated March 31, 1992, the Risk OII stated the following:

New or expanded facilities and the costs necessary to meet water quality standards mandated by the EPA and the DHS may well double the cost of water provided by small water companies. For the small utility, this problem is compounded by its inability to borrow from banks and other lending sources because of a history of inadequate earnings.

Considering that the proceeds of the unauthorized debt appear to have been used for the construction, completion, or improvement of the utility's facilities (a proper use under § 817), we will require YBWC to execute a replacement promissory note for each of the debt instruments, indicating the principal amount, as the outstanding balance of the loan, and the term, being the remaining years.

Our authorization is not to be construed as a finding on the reasonableness or value of YBWC's capital projects nor as indicative of the amounts to be included in proceedings for the determination of just and reasonable rates. Construction expenditures, the resulting interest rate and cost of money arising from debt capital, and the resulting plant balances in rate base are normally addressed in cost of capital or general rate case proceedings and are addressed herein.

Pursuant to § 851, we will allow the encumbrance of utility property to secure the debt authorized herein.

YBWC is put on notice, by this Resolution, that the Commission does not permit a utility, either through carelessness or design, to disobey the provisions of the Public Utilities Code and Commission orders, either in letter or in spirit. If in the future, the Commission becomes convinced that



any of its orders are being knowingly violated, YBWC will find us less accommodating. A penalty will not be imposed at this time.

We remind YBWC of the provision of § 856:

Every officer, agent or employee of a public utility, or of a subsidiary or affiliate of, or a corporation holding a controlling interest in, a public utility, and every other person subject to the requirements of this article, who violates or fails to comply with, or procures, aids, or abets any violation of, this article is guilty of a misdemeanor.

The fee for this financing authority as set forth by § 1904(b) is \$170.<sup>2</sup>

### **COMMENTS ON DRAFT RESOLUTION**

This is an uncontested matter in which the Resolution pertains solely to a water company. Accordingly, pursuant to § 311(g)(3), the 30-day period for public review and comment under § 311(g)(1) does not apply.

### **FINDINGS**

1. YBWC is presently carrying some unauthorized debt obligations and by its Advice Letter filing requests to rectify its omission.
2. The emergency repairs and improvements made to the 6 potable water mains of YBWC appear to be a proper use of funds to acquire financing authority under § 817(c).
3. YBWC should pay the fee determined in accordance with § 1904(b).
4. The promissory notes to Crown Pointe Estate at Malibu, LLC and pertinent documents were secured by YBWC without prior Commission authorization and are therefore void.
5. The execution of new promissory notes based on the outstanding balances and remaining terms are appropriate and for lawful purposes.
6. The execution and issuance of new debt instruments to replace the unauthorized transactions would not be adverse to the public interest.

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<sup>2</sup> The fee is determined as follows:  $(\$2 \times (85,000/1,000)) = \$170.00$ .

7. The Commission does not, by this Resolution, determine that YBWC's construction program, interest rates or other terms of the replacement debt are necessary or reasonable for ratemaking purposes. These issues is normally addressed in a general rate case.
8. There is not any known opposition, and there is no reason to delay granting the authority requested.

**THEREFORE, IT IS ORDERED THAT:**

1. Yerba Buena Water Company is authorized to execute and deliver new loan contracts with Crown Pointe Estate at Malibu, LLC, using the amount of the outstanding balances as principal amount, upon terms and conditions substantially consistent with those set forth or contemplated in Advice Letter No. 33.
2. Yerba Buena Water Company is authorized to encumber its assets in connection with the loan authorized herein.
3. Yerba Buena Water Company shall file with the Water Division a copy of the loan documents within 15 days of execution.
4. Because of its weak financial position that may threaten its ability to deliver clean, safe, and reliable drinking water to its customers, we will order Yerba Buena to request, within one hundred eighty days of this order, for authority to increase rates using the advice letter process.
5. Water Division is directed to mail a copy of this Resolution to:

Crown Pointe Estates at Malibu, LLC  
21800 Oxnard Street, Suite 1190  
Woodland Hills, CA 91367  
Attn: Richard G. Morris

6. The authority granted by this order shall become effective when Yerba Buena Water Company pays \$170, the fee set forth by Public Utilities Code § 1904(b).

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on April 27, 2006. The following Commissioners voting favorably thereon:

/s/ STEVE LARSON

STEVE LARSON  
Executive Director

MICHAEL R. PEEVEY  
President

GEOFFREY F. BROWN

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG  
Commissioners